ALERT: Barrick Gold (TSX:ABX) Just Plunged 9% — Buy the Dip or Bail?

Description

When it comes to gold stocks, **Barrick Gold** (TSX:ABX)(NYSE:ABX) is the gold standard. But as I've been warning investors in many prior pieces, shares look absurdly overvalued, especially given that gold prices are above and beyond that of their mid-cycle levels (around US$1,200-$1,300 per ounce).

While it's a good idea to have some exposure to alternative assets (that's alternative to equities, folks) such as gold miners and physical gold to be ready for tough times, it's a horrible idea to neglect the price you'll pay for an asset.

All that glitters isn't gold

Gold prices recently broke the US$2,000 mark. While some pundits claim that the shiny commodity has more room to run (I've heard the possibility of US$3,000 gold being thrown out there) because of these unpredictable market, the chances of gold getting cut in half is far more likely given its cyclical nature.

In essence, buying gold stocks with gold prices at these potentially unsustainable heights is a dangerous proposition, even though it may seem like a prudent move to help one's portfolio better weather this unprecedented crisis and defend against the threat of inflation.

And once a COVID-19 vaccine lands, either later this year or next year, a layer of uncertainty will be removed from this market and gold prices could crash as they did in the years that followed the recovery out of the Great Recession.

Take a page out of Warren Buffett's playbook

Warren Buffett isn't a fan of gold and for a good reason. It's an unproductive asset. Sure, a premier gold stock like Barrick will pay you a nice dividend (Barrick actually increased its quarterly dividend by 14% this week), but with a mere 1.2% yield, the income you'll receive from the name is likely not worth the risk of steep capital downside that could come from a sudden reversal in the price of gold.

Make no mistake: Barrick is a king among men as far as gold stocks are concerned. The COVID-19 pandemic barely hit Barrick in the first half of the year, the company's mine portfolio is very well diversified compared to its peers, and the management team is among the best in the business.

Still, the company will be at the mercy of gold prices, and unless you think gold can continue creeping above the US$2,000 mark, I don't think it makes sense to pay up for any gold miner, even Barrick, with its premium traits.

Barrick Gold's valuation is far too lofty

At the time of writing, Barrick stock trades at 4.9 times sales, 15.8 times cash flow, and 2.4 times book, all of which are considerably higher than that of the stock's five-year historical average multiples of 2.4, 8.4, and 2.0, respectively.

The inflation hedge and lower correlation to the broader equity markets (0.29 beta) you're getting are simply not worth the premium price tag. Investors who scoop up shares here could get punished once gold prices gravitate toward their mid-cycle prices.

More recently, Barrick shares plunged 9% in a day following a significant pullback in gold prices. Weakness is just the start and would encourage investors to take a rain check on all gold producers, especially Barrick, which still looks overpriced.

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